

Exhibit H

AMERICAN BAR FOUNDATION
Corporate Debt Financing Project

Commentaries

ON

MODEL DEBENTURE INDENTURE PROVISIONS
1965

MODEL DEBENTURE INDENTURE PROVISIONS
ALL REGISTERED ISSUES
1967

AND

CERTAIN NEGOTIABLE PROVISIONS
which may be included in a particular
INCORPORATING INDENTURE

1971

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§ 5-8, Unconditional Right, etc. to Receive Principal, etc.

Of course, any suit by one debentureholder seeking to collect the principal of his debenture might prejudice other holders who do not bring such a suit but this kind of action is an absolute right of the debentureholder under the debenture and Section 508 of the Model Provisions. The reference in the latter part of Section 507 to disturbing or prejudicing rights under the indenture developed from mortgage indenture language in which there is concern over disturbing the lien securing the bonds. One example of how a holder may affect the rights of other holders under a debenture indenture might be a suit for reformation of the indenture.

§ 5-8 [Section 508]. Unconditional Right of Debentureholders to Receive Principal, Premium and Interest.

Notwithstanding any other provision in this Indenture, the Holder of any Debenture shall have the right which is absolute and unconditional to receive payment of the principal of (and premium, if any) and interest on such Debenture on the respective Stated Maturities expressed in such Debenture (or, in the case of redemption, on the Redemption Date) and to institute suit for the enforcement of any such payment, and such right shall not be impaired without the consent of such Holder.

The provisions of Section 508 are mandatory in a qualified indenture by reason of TIA § 316(b). Provisions of the character of Section 508 were not common in indentures prior to the mid-1920's. Such provisions do, however, appear frequently in indentures in the late 1920's. The purpose of such provisions was to assure the negotiability of the debentures by making certain that the promise to pay contained therein was unconditional.

TIA § 316(b) refers only to payments on the "due dates expressed in such indenture" and therefore is not applicable to payments due by virtue of a call for redemption. Section 508 is made applicable to such redemption payments under the authority of TIA § 318(b), which provides that provisions additional to those required by the TIA may be included if not in contravention of the TIA provisions.

By the terms of the indenture, an acceleration of maturity can always be annulled by the holders of a majority in amount of the debentures. The procuring of a judgment by a few debentureholders on

§ 5-9, Restoration of Rights and Remedies
 § 5-10, Rights and Remedies Cumulative

the basis of the accelerated maturity and a subsequent rescission of acceleration would present a most difficult problem whose solution is not to be found in any decided case.

In cases where the indenture contains a limitation against suit on the indenture similar to Section 507, but does not contain an express affirmation of the holder's right to sue on the debentures similar to that in Section 508, the courts nevertheless have generally allowed the holder's suit on the debt obligation. Various grounds have been cited in various fact situations, including the inapplicability of an indenture restriction to a holder without actual notice, and the very distinction made by the express reference in the indenture restriction to suits only "under the Indenture".²⁴

§ 5-9 [Section 509]. Restoration of Rights and Remedies.

If the Trustee or any Debentureholder has instituted any proceeding to enforce any right or remedy under this Indenture and such proceeding has been discontinued or abandoned for any reason, or has been determined adversely to the Trustee or to such Debentureholder, then and in every such case the Company, the Trustee and the Debentureholders shall, subject to any determination in such proceeding, be restored severally and respectively to their former positions hereunder, and thereafter all rights and remedies of the Trustee and the Debentureholders shall continue as though no such proceeding had been instituted.

§ 5-10 [Section 510]. Rights and Remedies Cumulative.

No right or remedy herein conferred upon or reserved to the Trustee or to the Debentureholders is intended to be exclusive of any other right or remedy, and every right and remedy shall, to the extent permitted by law, be cumulative and in addition to every other right and remedy given hereunder or now or hereafter existing at law or in equity or otherwise. The assertion or employment of any right or remedy hereunder, or otherwise, shall not prevent the concurrent assertion or employment of any other appropriate right or remedy.

Sections 509 and 510 are of greater moment in mortgage indentures where a greater variety of rights and remedies are always provided, such as the trustees' right of entry on and possession of the

²⁴ See McCLELLAND & FISHER, *supra* note 13, at 135-40. Cf. *Bartol v. Gottlieb-Bauernschmidt-Straus Brewing Co.*, 129 Md. 32, 98 A. 286 (1916), discussed in § 5-7 (Limitation on Suits).

§ 10-10, Limitations on Encumbrances—Sample Covenants 1 and 2

senior position as against the assets of the subsidiary there is no objection from the parent corporation's debentureholders.

The Sample Covenants which follow set forth limitations on liens, encumbrances, priorities and related matters as well as some common exceptions to such limitations. For purposes of illustration, they are made applicable to subsidiaries.

V. Sample Covenants

SAMPLE COVENANT 1

(Short Form)

§ 10-10. Limitation on Liens.

The Company will not itself, and it will not permit any Subsidiary to, create, assume, incur or suffer to be created, assumed or incurred or to exist any mortgage, pledge, encumbrance, lien or charge of any kind upon any of the properties of any character of the Company or any Subsidiary, whether owned at the date hereof or thereafter acquired, or acquire or agree to acquire any property of any character under any conditional sale agreement or other title retention agreement (including any lease in the nature of a title retention agreement);

[Appropriate exceptions to be included here; see Sample Covenant 3]

SAMPLE COVENANT 2

(Limited to Indebtedness [For Borrowed Money])

§ 10-10. Limitation on Liens.

The Company will not, and will not permit any Subsidiary to, create or suffer to exist any mortgage, pledge, lien, security interest, assignment or transfer upon or of any of its property or assets, now owned or hereafter acquired, to secure any indebtedness [for borrowed money] without making effective provision whereby all of the Debentures shall be directly secured equally and ratably with the indebtedness secured by such mortgage, pledge, lien, security interest, assignment or transfer;

[Appropriate exceptions to be included here; see Sample Covenant 3]

§ 10-10, Limitations on Encumbrances—Sample Covenant 3

SAMPLE COVENANT 3

(Composite with Numerous Inclusions and Exclusions)²¹

§ 10-10. Limitation on Liens.

The Company will not, and will not permit any Subsidiary to,

A. create, assume or incur or suffer to be created, assumed or incurred or to exist any mortgage, lien, charge or encumbrance of any kind upon, or pledge of, any of the property of any character of the Company or any Subsidiary, whether owned at the date hereof or hereafter acquired; or

B. acquire or agree to acquire any property of any character under any conditional sale agreement or other title retention agreement (including any lease in the nature of a title retention agreement); or

C. by transfer to any Subsidiary, subject to the prior payment of any Debt other than that represented by the Debentures, any property of any character of the Company or any Subsidiary;²² or

D. give its consent to the subordination of any right or claim of the Company or any Subsidiary to any right or claim of any other person; or

E. sign or file a financing statement under the Uniform Commercial Code which names the Company or any Subsidiary as debtor or sign any security agreement authorizing any secured party thereunder to file such financing statement; or

F. suffer to exist any Debt of the Company or of any Subsidiary or any claims or demands against the Company or any Subsidiary, which, if unpaid, might (in the hands of the holder or anyone who shall have guaranteed the same or who has any right or obligation to purchase the same) by law or upon bankruptcy or insolvency or otherwise, be given any priority whatsoever over its general creditors;

²¹ Sample Covenant 3 is a composite containing all the limitations and exceptions referred to in the preceding discussion. In all likelihood, the composite would not appear in its complete form in any indenture.

²² This clause was generated originally by the transaction involved in *In re Associated Gas & Electric Co.*, *supra* note 16, 61 F.Supp. 11,359, and has been used primarily in direct placements. Although this clause seems to serve the purpose of preventing the circumvention of a negative pledge covenant such as occurred in these two cases, events may prove that the prohibition is so broad that, in its unlimited coverage, it might prevent a transaction beneficial to all concerned (e.g., financial assistance by the parent corporation to an existing subsidiary), unless consent of the lenders is obtained.

§ 10-10, Limitations on Encumbrances—Sample Covenant 3

excluding, however, from the operation of the foregoing:

(1) mortgages, liens, charges, pledges or other security interests or encumbrances created by any Subsidiary as security for Debt owing to the Company [or to another Subsidiary],

(2) (a) liens for taxes or assessments or other governmental charges or levies to the extent not required to be paid by § 10 - 4,

(b) pledges or deposits to secure obligations under workmen's compensation laws or similar legislation, including liens of judgments thereunder which are not currently dischargeable,

(c) pledges or deposits to secure performance in connection with bids, tenders, contracts (other than contracts for the payment of money) or leases made in the ordinary course of business to which the Company or any Subsidiary is a party as lessee,

(d) deposits to secure public or statutory obligations of the Company or any Subsidiary,

(e) materialmen's, mechanics', carriers', workmen's, repairmen's, or other like liens arising in the ordinary course of business, or deposits to obtain the release of such liens,

(f) deposits to secure, or in lieu of, surety, appeal or customs bonds in proceedings to which the Company or any Subsidiary is a party,

(g) liens created by or existing from any litigation or legal proceeding which is currently being contested in good faith by appropriate proceedings,

(h) leases made, or existing on property acquired, in the ordinary course of business,

(i) statutory landlords' liens under leases to which the Company or any Subsidiary is a party,

(j) zoning restrictions, easements, licenses, restrictions on the use of real property or minor irregularities in title thereto, which do not, in the opinion of the Board of Directors, materially impair the use of such property in the operation of the business of the Company or any Subsidiary or the value of such property for the purpose of such business, and

(k) claims of creditors entitled to priority under the so-called "6 months rule" as applied by courts of equity in proceedings for the administration of insolvent corporations;

§ 10-10, Limitations on Encumbrances—Sample Covenant 3

(3) Purchase money mortgages, liens, pledges or security interests (which term for purposes of this Subsection (3) shall include conditional sale agreements or other title retention agreements and leases in the nature of title retention agreements) upon or in property acquired after , or mortgages, liens, pledges or security interests existing in such property at the time of acquisition thereof, or, in the case of any corporation which thereafter becomes a Subsidiary, mortgages, liens, pledges or security interests upon or in its property, existing at the time such corporation becomes a Subsidiary provided that

(a) no such mortgage, lien, pledge or security interest extends or shall extend to or cover any property of the Company or such Subsidiary, as the case may be, other than the property then being acquired and fixed improvements then or thereafter erected thereon,

(b) the aggregate principal amount of all Debt of the Company and all Subsidiaries secured by all mortgages, liens, pledges or security interests described in this Subsection (3) (including extensions, renewals and replacements thereof as permitted by subparagraph (d) of this Subsection (3)) shall not exceed \$. at any one time outstanding,

(c) except with respect to trucks and other delivery equipment and all major items of office equipment purchased under credit terms customarily extended to purchasers by the manufacturers or other sellers thereof and having an aggregate cost at any one time of not more than \$. , the aggregate principal amount of Debt secured by mortgages, liens, pledges and security interests described in this Subsection (3) at the time of acquisition of the property subject thereto shall not exceed . . . % of the cost of such property or of the then fair value of such property as determined by the Board of Directors, whichever shall be less,

(d) the replacement, extension or renewal of any mortgage, lien, pledge or security interest permitted by Subsection (3) of this Section upon or in the same property theretofore subject thereto or the replacement, extension or renewal (without increase of principal amount) of the Debt secured thereby, and

(e) immediately after giving effect to the Debt secured by any such mortgage, lien, pledge or security interest the Consolidated Net Tangible Assets of the Company and its [Consoli-

§ 10-10, Limitations on Encumbrances—Sample Covenant 4

dated] Subsidiaries shall not be less than . . . % of the Consolidated Funded Debt of the Company and its [Consolidated] Subsidiaries;

(4) mortgages, liens, pledges or other security interests upon the fee or a leasehold interest in mining property or oil or gas property or upon minerals, oil or gas produced or extracted from such property, to secure liabilities for the payment of the purchase price thereof, but such mortgages, liens, pledges or other security interests shall be deemed to be purchase money mortgages for the purposes of Subsection (3) above;

(5) any charge or encumbrance arising from a conveyance by the Company or a Subsidiary of a production payment with respect to mineral deposits located in owned or leased by the Company or a Subsidiary;

(6) farm-out or carried working interest agreements for development by the Company or others of non-producing leases or non-producing portions of oil or gas producing property; and

(7) participations in joint operating agreements and unitization agreements and operations covering oil and gas producing properties.

An oil or gas royalty, overriding royalty or production payment shall not be deemed to be a charge or encumbrance upon the related working interest.

SAMPLE COVENANT 4

(Negative Covenant—Ratable Security)

§ 10-10. Limitation on Liens.

Except as hereinbelow in this Section expressly provided, the Company will not, and will not permit any Subsidiary to, (i) create, assume, incur or suffer to be created, assumed or incurred or to exist any mortgage, lien, pledge, charge or encumbrance of any kind upon any property of any character of the Company or any Subsidiary, whether owned at the date hereof or hereafter acquired, without making effective provision whereby all of the Debentures shall be directly secured equally and ratably with the indebtedness or other obligations secured by such mortgage, lien, pledge, charge or encumbrance, or (ii) acquire or agree to acquire any property of any character subject to any conditional sales agreement or other title retention agreement;

[Appropriate exceptions to be included here; see Sample Covenant 3]

§ 10-10, Limitations on Encumbrances—Sample Covenants 4A and 5

SAMPLE COVENANT 4A

(Negative Covenant—Ratable Security—Alternative Form)²³

§ 10-10. Limitation on Liens.

The Company will not, and will not permit any Subsidiary to, create, assume, incur or suffer to be created, assumed or incurred or to exist, any mortgage, lien, pledge, charge or other encumbrance of any kind upon any property of any character of the Company or any such Subsidiary, or acquire or agree to acquire any property of any character subject to any conditional sale agreement or other similar title retention agreement, without making effective provision, and the Company covenants that in any such case it will make or cause to be made effective provision, whereby the Debentures then Outstanding shall be directly secured by such mortgage, pledge, charge, lien, encumbrance or agreement equally and ratably upon the same property or assets with any and all other obligations and indebtedness thereby secured;

[Appropriate exceptions to be included here; see Sample Covenant 3]

SAMPLE COVENANT 5

(Affirmative Covenant—Ratable Security)

§ 10-10. Limitation on Liens.

If the Company directly or indirectly creates, incurs, assumes or permits to exist or allows any Subsidiary directly or indirectly to create, incur, assume or permit to exist any mortgage, pledge, lien, encumbrance or charge (including the charge upon property purchased under any conditional sale or other title retention agreement) on any property or asset of the Company or any Subsidiary, whether owned at the date hereof or hereafter acquired, it covenants that in any such case provision will be made, in the mortgage or instrument of pledge or otherwise so that so long as any Debt secured by the lien of such mortgage, pledge, lien, encumbrance or charge is outstanding, (a) the Debentures shall share equally and ratably with (or prior to) all other Debt to be secured by the lien of such mortgage or pledge in the benefits of the lien of such mortgage or pledge and (b) the Debentures shall be entitled so to share in such benefits without first exhausting any other right created by this Indenture or otherwise for their protection, and shall be entitled to share in such benefits irrespective of the fact that the other Debt to be secured by such mortgage or pledge may or

²³ The difference between Sample Covenants 4 and 4A is that in the latter conditional sales and title retention agreements are permitted if the debentures are ratably secured with the amounts outstanding under such agreements, but acquisitions of property subject to conditional sales or title retention agreements are not permitted at all under Sample Covenant 4.

§ 10-10, Limitations on Encumbrances—Sample Covenant 6

shall mature normally or by acceleration prior to the maturity of the Debentures [and the Company further covenants that, if such provision is not made, an equitable lien, so equally and ratably securing the Debentures shall exist on such property or assets, but that failure specifically to make such provision shall nevertheless constitute a default in the performance of the foregoing covenant];

[Appropriate exceptions to be included here; see Sample Covenant 3]

SAMPLE COVENANT 6

(Prohibition on Mortgages—Limited Form)

§ 10-10. Limitation on Liens.

The Company will not mortgage as security for any obligation for money borrowed any real estate, plants or equipment used for manufacturing in the United States, except for purchase money mortgages or assumptions of mortgages on such property acquired by the Company and any renewal of or substitution for the same.

§ 10-11, Limitations on Debt—Sample Covenant 1

investments should be limited in the same manner as funded debt or limited by covenants of the type discussed in the Commentary on § 10-16 (Investments).

IV. Sample Covenants

SAMPLE COVENANT 1

(Limiting Funded Debt of Company by a Net Tangible Assets Test, with a Separate Limitation on Subsidiary Debt)

§ 10-11. Limitations on Funded Debt of the Company and Subsidiaries.

(a) The Company will not incur, or otherwise become liable in respect of, any Funded Debt unless, after giving effect to such Funded Debt *and the receipt and application of the net proceeds thereof*,³⁸ Consolidated Net Tangible Assets will be at least %³⁹ of the aggregate principal amount of Consolidated Funded Debt to be outstanding.

(b) The Company will not permit any [Restricted] Subsidiary⁴⁰ to incur, or otherwise become liable in respect of, any Funded Debt except

(i) Funded Debt owing to the Company or a [Wholly-owned] [Restricted] Subsidiary, or

(ii) Funded Debt secured by mortgages or other liens permitted by § 10-10.

(Treatment of Funded Debt of a Successor Corporation)

[In case any corporation shall become a successor to the Company pursuant to any consolidation, merger, conveyance or transfer permitted by § 8-1, such successor corporation shall be deemed to have incurred at the time of such consolidation, merger, conveyance or transfer all Funded Debt outstanding after the consummation of such

³⁸ As to the advisability of inserting or omitting the italicized phrase here and in the other Sample Covenants, see the discussion in paragraph (d) of Part II A-1 of this Commentary.

³⁹ This figure will always be a matter of negotiation. Important factors in such negotiation will be the type of business in which the Company is engaged, its earnings history, its credit standing and the rating of its debt securities. The figure will, of course, always be more than 100%. There are indentures in which the figure is as low as 125% and other indentures in which it is in the 300% area; and there are indentures in which there is no limitation on the creation of funded debt by the Company.

⁴⁰ The other Sample Covenants do not differentiate between restricted and unrestricted subsidiaries, but apply to subsidiaries generally. Therefore, in adapting them for use in an indenture which differentiates between restricted and unrestricted subsidiaries, appropriate changes should be made.

§ 10-11, Limitations on Debt—Sample Covenant 1A

consolidation, merger, conveyance or transfer other than Funded Debt of the Company which was outstanding immediately prior thereto.]

Comments on Sample Covenants 1A, 1B and 1C

The ensuing Sample Covenants 1A, 1B and 1C illustrate some possible variations of the basic limitation expressed in Sample Covenant 1.

(1) 1A adds an earnings test for funded debt of the Company.

(2) 1B eliminates the separate limitation on funded debt of subsidiaries contained in paragraph (b) of Sample Covenant 1 and treats such funded debt in the same manner as funded debt of the Company. It also makes the net tangible assets test applicable to preferred stock of subsidiaries and adds an exception for refunding transactions.

(3) 1C provides a qualified exception for Subordinated Debt.

It will be noted that (except as provided in (b) (ii) of Sample Covenant 1) the covenants in this group embrace secured as well as unsecured funded debt. Exceptions (of the type illustrated by Sample Covenant 3) may, therefore, be introduced where appropriate.

SAMPLE COVENANT 1A

(Limiting Funded Debt of Company by an Earnings Test as well as a Net Tangible Assets Test)

§ 10-11. Limitations on Funded Debt of the Company and Subsidiaries.

(a) The Company will not incur, or otherwise become liable in respect of, any Funded Debt unless, after giving effect to such Funded Debt and the receipt and application of the net proceeds thereof:

(i) Consolidated Net Tangible Assets will be at least % of the aggregate principal amount of Consolidated Funded Debt to be outstanding; and

(ii) Consolidated Income Available for Interest for a 12-month period ending not more than 3 months prior to the date on which the Company becomes liable in respect of such additional Funded Debt will be at least times total annual interest charges on the Consolidated Funded Debt to be outstanding.

(b) [Here limit Subsidiary debt as in (b) of Sample Covenant 1.]

**§ 10-11, Limitations on Debt—Sample
Covenants 1B and 1C**

SAMPLE COVENANT 1B

(Limiting Funded Debt of Company and Funded Debt and Preferred Stock of Subsidiaries by a Net Tangible Assets Test, with an Exception for Refundings)

§ 10-11. Limitations on Funded Debt of the Company and on Funded Debt and Preferred Stock of Subsidiaries.⁴¹

Neither the Company nor any Subsidiary will incur, or otherwise become liable in respect of, any Funded Debt and no Subsidiary will issue any Preferred Stock, unless, after giving effect to such Funded Debt and the receipt and application of the net proceeds of such Funded Debt or Preferred Stock, Consolidated Net Tangible Assets will be at least% of the aggregate principal amount of Consolidated Funded Debt and the aggregate amount of Preferred Stock of Subsidiaries to be outstanding; provided that the foregoing provision of this § 10-11 shall not prevent

(i) the Company or any Subsidiary from incurring Funded Debt to refund at least an equal aggregate principal amount of its then outstanding Funded Debt [(or debt which was Funded Debt at the time it was incurred)]⁴²; or

(ii) any Subsidiary from issuing Preferred Stock to refund at least an equal aggregate amount of its then outstanding Preferred Stock; or

(iii) any Subsidiary from incurring Funded Debt, or issuing Preferred Stock, to the Company.

For purposes of this § 10-11, "aggregate amount", as used with respect to any Preferred Stock, means the aggregate preferential amount to which such stock would be entitled on any involuntary distribution of assets.

SAMPLE COVENANT 1C

(Limiting Funded Debt of Company by a Net Tangible Assets Test, with a Separate Test for Subordinated Debt)

§ 10-11. Limitations on Funded Debt of the Company.

(a) The Company will not incur, or otherwise become liable in respect of, any Funded Debt unless, after giving effect to such Funded Debt and the

⁴¹ Another method of covering preferred stock of subsidiaries would be to include it in the definition of "Funded Debt".

⁴² The purpose of the bracketed language is to avoid the pitfall which may preclude refunding when, by definition, funded debt depends upon the date of determination rather than the date of creation, and a particular funded debt ceases to be funded debt when its maturity is no more than one year from the date of determination.

§ 10-11, Limitations on Debt—Sample Covenant 2

receipt and application of the net proceeds of such Funded Debt, Consolidated Net Tangible Assets will be at least%⁴³ of the aggregate principal amount of Consolidated Senior Funded Debt [and at least% of the aggregate principal amount of Consolidated Funded Debt] to be outstanding; provided, however, that the foregoing provisions of this § 10-11 shall not prevent

(i) the Company from incurring Subordinated Funded Debt [if, after giving effect thereto and to the receipt and application of the net proceeds thereof, Consolidated Net Tangible Assets will be at least% of the aggregate principal amount of Consolidated Funded Debt to be outstanding];

(ii) the Company from incurring Senior Funded Debt to refund at least an equal aggregate principal amount of its then outstanding Senior Funded Debt; or

[(iii) the Company from issuing Subordinated Funded Debt to refund at least an equal aggregate amount of its then outstanding Funded Debt.]

(b) [Here limit Subsidiary debt as in (b) of Sample Covenant 1.]

If subordinated debt of the Company is to be permitted without limitation,

(1) “Funded Debt” could be defined to exclude subordinated debt of the Company;

(2) it would be unnecessary to refer to and define “Senior Funded Debt”; and

(3) the bracketed passages in (a) could be omitted.

SAMPLE COVENANT 2

(Limiting Funded Debt of Company by a Capitalization Test, with a Separate Limitation on Subsidiary Debt)

§ 10-11. Limitations on Funded Debt of the Company and Subsidiaries.

(a) The Company will not incur, or otherwise become liable in respect of, any Funded Debt unless, after giving effect to such Funded Debt and

⁴³ The figure in the first blank will, of course, be greater than the figure in the second and third blanks.

§ 10-11, Limitations on Debt—Sample Covenant 2

the receipt and application of the net proceeds thereof, Consolidated Funded Debt shall be not more than%⁴⁴ of Consolidated Capitalization.

(b) The Company will not permit any Subsidiary to incur, or otherwise become liable in respect of, any Funded Debt except

(i) Funded Debt owing to the Company or a [Wholly-owned] Subsidiary, or

(ii) Funded Debt secured by mortgages or other liens permitted by § 10-10.

Comments on Sample Covenants 2 and 2A

Sample Covenant 2 corresponds to Sample Covenant 1, except that it substitutes a capitalization test for a net tangible assets test. It may be varied, as in Sample Covenant 2A, by

(a) eliminating the separate limitations on subsidiary debt and making the capitalization test for funded debt applicable alike to funded debt of the Company and funded debt of its subsidiaries, and

(b) adding an earnings test which (i) is applicable to all debt (both current and funded) and (ii) requires coverage for sinking fund as well as interest payments.

The covenant may be further varied by

(i) the inclusion or exclusion of investments in the definition of capitalization;

(ii) making the covenant applicable to investments as well as funded debt;

(iii) limiting debt of the Company and its subsidiaries in relation to the capitalization of the Company (without including therein the surplus of subsidiaries or the Company's investment in such subsidiaries); and/or

(iv) excluding guaranties from funded debt and including them in investments.

⁴⁴ This figure will always be a matter of negotiation. It will be substantially the reciprocal of the percentage figure that would be used in a net tangible assets test (see note 39). Thus, the figure would probably be in the range between a high of 80% and a low of 33⅓%.

§ 10-11, Limitations on Debt—Sample Covenant 2A

Since paragraph (b) of Sample Covenant 2A applies to all debt (both funded and current) of subsidiaries and does not include an exception (such as that contained in Sample Covenant 3) for such items as current liabilities (other than for borrowed money) incurred in the ordinary course of business, a more limited definition of debt should be used in conjunction with this covenant.

SAMPLE COVENANT 2A

(Capitalization Test for Funded Debt, and Earnings Test for Funded and Current Debt, of Company and Subsidiaries)

§ 10-11. Limitations on Debt of the Company and Subsidiaries.

(a) Neither the Company nor any Subsidiary will incur any Funded Debt (other than Funded Debt owing to the Company)⁴⁵ unless, after giving effect thereto and to the application of the proceeds thereof, Consolidated Funded Debt shall be not more than % of Consolidated Capitalization (determined as of the last day of the 12 months' period for which Consolidated Income Available for Interest is calculated for purposes of paragraph (b) of this § 10-11, but adjusted to give effect to the incurring of such additional Funded Debt, to the application of the proceeds thereof and to any dividend declared or other distribution of assets made by the Company to its stockholders, after the last day of such period and prior to, or simultaneously with, the proposed transaction).

(b) Neither the Company nor any Subsidiary will incur any Debt unless

(1) Consolidated Income Available for Interest for any 12 consecutive calendar months within the 15 calendar months immediately preceding the date on which such additional Debt is so incurred shall have been not less than times the annual interest charges on the Consolidated Debt to be outstanding immediately after the incurring of such additional Debt; and

(2) Consolidated Income Available for Debt Service for said 12 months' period shall have been not less than times the Maximum Annual Service Charge on the Consolidated Debt to be outstanding immediately after the incurring of such additional Debt.

⁴⁵ Funded debt owing by a subsidiary to the Company would not be included in consolidated funded debt. However, if the parenthetical clauses were omitted, the Company would not be permitted to make a loan to a subsidiary if, at the time, consolidated funded debt (excluding intercompany debt) exceeded the specified percentage of capitalization.

§ 10-11, Limitations on Debt—Sample Covenant 3

For the purposes of this § 10-11, Debt shall be deemed to be "incurred" by the Company or a Subsidiary whenever the Company or such Subsidiary shall create, assume, guarantee or otherwise become liable in respect thereof.⁴⁶

SAMPLE COVENANT 3

(Limiting Current and Funded Debt of Company and Subsidiaries, with Separate Treatment for Company and Subsidiaries)

§ 10-11. Limitation on Debt of the Company and Subsidiaries.

Neither the Company nor any Subsidiary will incur or otherwise become liable in respect of any Debt other than

(1) in the case of the Company,

(a) unsecured Current Debt incurred in the ordinary course of business as a result of borrowing; provided, that there has been a period of consecutive days within the period of consecutive months immediately preceding the date of the incurring or renewal of such Debt during which the Company has been free from Current Debt resulting from borrowing (excluding prepayments, fixed sinking fund payments or other payments required to be made with respect to Debt incurred as Funded Debt),⁴⁷

(b) unsecured Senior Funded Debt; provided that the Company shall not incur any such Debt if, immediately after giving effect to the incurring of such Debt and the receipt and application of the proceeds thereof, (i) the aggregate principal amount of Consolidated Senior Funded Debt would exceed % of the aggregate amount of Consolidated Net Tangible Assets; or (ii) the aggregate principal amount of Consolidated Funded Debt would exceed % of the aggregate amount of Consolidated Net Tangible Assets,

(c) Subordinated Debt; provided, however, that the Company shall not incur any such Debt if, immediately after giving effect to the incurring of such Debt and the receipt and application of the proceeds thereof, the aggregate principal amount of Consolidated Funded Debt would exceed % of the aggregate amount of Consolidated Net Tangible Assets,⁴⁸ and

⁴⁶ For convenience in stating the earnings tests, this covenant uses only the verb "incur" and omits the words "or otherwise become liable in respect of". Hence the final sentence.

⁴⁷ The parenthetical clause should be used if current debt is defined for other purposes as including such payments.

⁴⁸ Subordinated debt will, by definition, be both unsecured and funded. If there is to be no limitation on subordinated debt, the italicized portions of (b), (c) and (d) should be deleted.

§ 10-11, Limitations on Debt—Sample Covenant 3

(d) unsecured Senior Funded Debt incurred for the purpose of (and substantially concurrently with the) refunding⁴⁹ of any Senior Funded Debt and Subordinated Debt incurred for the purpose of (and substantially concurrently with the) refunding of any Senior Funded Debt or Subordinated Debt; provided that the Senior Funded Debt or Subordinated Debt being refunded was permitted by this Indenture;

(2) in the case of any Subsidiary, Debt owing to the Company or to a [Wholly-owned] Subsidiary;

(3) in the case of the Company and any Subsidiary,

(a) Debt for taxes, assessments and governmental charges or levies and claims for labor, materials and supplies (as and to the extent permitted to remain unpaid and undischarged by § 10-4⁵⁰),

(b) secured Debt as and to the extent permitted to be secured by § 10-10,

(c) Debt represented by dividends declared but not paid, subject, however, in the case of the Company, to the provisions of § 10-12, and

(d) unsecured Current Debt incurred in the ordinary course of business and not as a result of borrowing or in respect of obligations of others.

Comments on Sample Covenant 3

The special exceptions in (a), (c) and (d) of (3) above are needed if debt is defined as in Sample Definitions A and B of “Debt” in Part III(1) of § 1-1(c) (Other Definitions) and current debt is defined as in Sample Definitions A and B of “Current Debt” in Part III(4) of § 1-1(c). Compare Sample Definition C of “Debt” set forth in Part III(1) of § 1-1(c).

The covenant is sometimes varied by adding to (1)(a) a dollar limitation on current debt.

It will be noted that the net tangible assets test applies only to *unsecured* funded debt and that there is an exception in (3)(b) for secured debt permitted by the negative pledge clause. This presupposes

⁴⁹ See note 42.

⁵⁰ See § 10-4 (Payment of Taxes and Other Claims). It will be noted that Section 1004 of the Model Provisions deals only with the deferment of payment, not with the incurring of debt.

§ 10-11, Limitations on Debt—Sample Covenant 4

that any desired limitation on secured funded debt will be included in the negative pledge clause.

SAMPLE COVENANT 4

(Limiting Funded Debt of Company by a Tangible Net Worth Test, with a Separate Limitation on Subsidiaries' Debt)

§ 10-11. Limitations on Funded Debt of the Company and Subsidiaries.

(a) The Company will not incur, or otherwise become liable in respect of, any Funded Debt, unless, after giving effect to such Funded Debt and the receipt and application of the net proceeds thereof, the aggregate principal amount of Consolidated Funded Debt to be outstanding shall not exceed % of Consolidated Tangible Net Worth.

(b) The Company will not permit any Subsidiary to incur, or otherwise become liable in respect of, any Funded Debt except

(i) Funded Debt owing to the Company or a [Wholly-owned] Subsidiary, or

(ii) Funded Debt secured by mortgages or other liens permitted by § 10-10.

**§ 10-12, Restrictions on Dividends, etc.—
Sample Covenant 1**

Some indentures include both tests on the theory that the absolute maintenance test establishes a rock-bottom level and voluntary distributions ought to be restricted at a somewhat higher level.

Following are sample dividend covenants which illustrate some of the numerous variations which are common.

III. Sample Covenants

SAMPLE COVENANT 1

**(Dividends, and Retirements in Excess of New Issues, Limited to Future Net Income
and Conditioned on Maintaining a Minimum Working Capital)**

§ 10-12. Limitations on Dividends and Other Distributions.

The Company will not, in respect of any shares of any class of its capital stock,

A. declare or pay any dividends (other than dividends payable in capital stock of the Company) thereon, or

B. apply any of its property or assets to the purchase, redemption or other acquisition or retirement thereof, or

C. set apart any sum for the purchase, redemption or other acquisition or retirement thereof, or

D. make any other distribution, by reduction of capital or otherwise

unless, immediately after such declaration in the case of a dividend or immediately after such other action, the following conditions shall be fulfilled, namely:

(i) the sum of

(a) the aggregate amount declared as dividends (other than dividends paid or payable in capital stock of the Company) on all shares of stock of all classes of the Company, plus the amount of any other distributions by reduction of capital or otherwise, subsequent to [the peg date], and

(b) the excess, if any, of (x) the aggregate amount of property, assets or sums applied to, or set apart for, the

**§ 10-12, Restrictions on Dividends, etc.—
Sample Covenants 2 and 3**

purchase, redemption or other acquisition or retirement of shares of stock of all classes of the Company subsequent to [the peg date], over (y) the aggregate amount received by the Company as the net cash proceeds of issuance or sale of shares of stock of the Company subsequent to [the peg date],

will not be in excess of the Net Income of the Company accrued subsequent to [the peg date]; and

(ii) the Net Current Assets of the Company will be not less than \$⁹

SAMPLE COVENANT 2

(Distributions Conditioned on Maintenance of Net Worth)

§ 10-12. Limitations on Dividends and Other Payments on Stock.

The Company will not declare or pay any dividends or make any distributions upon any Common Stock of the Company (other than dividends and distributions payable only in shares of Common Stock of the Company) and will not directly or indirectly apply any of the assets of the Company to the redemption, retirement, purchase or other acquisition of any stock of the Company of any class unless after giving effect to such declaration, payment, distribution or application of assets the Tangible Net Worth of the Company shall be at least equal to \$

SAMPLE COVENANT 3

(Distributions in any Fiscal Year Limited to a Portion of the Net Income
for the Preceding Fiscal Year)

§ 10-12. Limitations on Dividends and Other Distributions.

The Company will not during any fiscal year of the Company pay any dividends or make any other distributions (other than dividends or

⁹ As to working capital maintenance requirements generally and as part of the dividend restriction, see § 10-15 (Maintenance of Working Capital). In some indentures (usually in addition to but sometimes in lieu of the conditions based on net worth and working capital) other financial ratios are imposed as conditions on distributions to shareholders. The parties may agree that, under the circumstances of a particular company, such financial ratios are necessary or more practical than the more usual conditions. Such conditions can be expressed in any of the Sample Covenants set forth in this Commentary as additions or substitutions for the conditions already stated. For example:

unless immediately after giving effect to such action Net Tangible Assets would not be less than% of Funded Debt.

**§10-12, Restrictions on Dividends, etc.—
Sample Covenant 4**

distributions payable in shares of any class of stock of the Company) on any shares of any class of stock of the Company, or directly or indirectly apply any assets of the Company to the redemption, retirement, purchase or other acquisition of any shares of any class of stock of the Company if after giving effect to such payment, distribution or application the aggregate amount of such dividends, distributions and application of assets paid or made during such fiscal year would be in excess of . . % of the Net Income of the Company for the fiscal year immediately preceding the year in which any such dividend is paid, or any such distribution or application of assets is made, and the right to make such payments, distributions and application of assets shall be non-cumulative from fiscal year to fiscal year.

SAMPLE COVENANT 4

(Expanded Form Covering Practically All Types of Payments
and Distributions to Shareholders)

To avoid a multiplicity of examples, which in any event could not cover the many combinations of elements which the parties might negotiate, the following Sample Covenant sets forth an expanded form covering practically all types of payments and distributions to shareholders.

§ 10-12. Limitations on Dividends and Other Stock Payments.

The Company will not declare any dividends on any class of its stock or make any payment on account of, or set apart money for a sinking or other analogous fund for, the purchase, redemption or other retirement of any shares of such stock, or make any distribution in respect thereof, either directly or indirectly, and whether in cash or property or in obligations of the Company (such dividends, payments and distributions being herein called "*Stock Payments*"), unless such dividends are declared to be payable not more than 60 days after the date of declaration, and unless, after giving effect to such proposed Stock Payment, all of the conditions set forth in the following Subsections A to D, inclusive, shall exist at the date of such declaration (in the case of a dividend) or at the date of such setting apart in the case of any such fund, or the date

**§ 10-12, Restrictions on Dividends, etc.—
Sample Covenant 4**

of such other payment or distribution in the case of any other Stock Payment (each such date being herein called a "Computation Date"):

A. no Event of Default has occurred which has not been cured.

B. the sum of

(1) \$ [the dip];

(2) plus (or minus in the case of a deficit)¹⁰ the Consolidated Net Income of the Company and its Consolidated Subsidiaries computed for the period beginning [the peg date]¹¹ to and including the Computation Date;

(3) plus the aggregate amount of all contributions to capital (including the fair value of property other than cash) received by the Company during such period;

(4) plus the aggregate net proceeds (including the fair value of property other than cash) received by the Company from the issue or sale of any class of its stock during such period;

shall be greater than all Stock Payments declared (in the case of dividends) or set apart (in the case of any such fund) or made (in the case of any other Stock Payment) during such period.

C. the Consolidated Working Capital [Consolidated Net Tangible Assets] [Consolidated Tangible Net Worth] of the Company and its Consolidated Subsidiaries shall be at least \$

D. After deducting from both Consolidated Current Assets and Consolidated Current Liabilities of the Company and its Consolidated Subsidiaries an amount equal to the aggregate amount included in Consolidated Current Liabilities

(1) as provision for taxes (to the extent not then due, or if due, payable without penalty) measured by income or profits or by salaries or wages, and

(2) as liabilities to the federal or any state government, or to any subdivision or agency of any thereof, on account of amounts withheld or collected from salaries or wages of persons in its employ under any income tax law or any social security law applicable to such persons, or on account of amounts withheld or collected from employees for the purpose of purchasing obligations of the federal government,

¹⁰ If only a portion of such net income is to be included in the formula, there will be inserted at this point such words as "an amount equal to ...% of".

¹¹ Usually the peg date will be the same throughout the Section although special circumstances may dictate that different dates be used for different purposes.

§ 10-12, Restrictions on Dividends, etc.—
Sample Covenant 4

the remaining Consolidated Current Assets of the Company and its Consolidated Subsidiaries shall be at least % of the remaining Consolidated Current Liabilities of the Company and its Consolidated Subsidiaries.

Provided, however, that this Section shall not apply to, and the term "Stock Payment" shall not include, dividends payable solely in any class of stock of the Company, or the purchase, redemption or other retirement of any stock of any class of the Company by exchange for, or out of the proceeds of the substantially concurrent sale of, shares of any other class of stock of the Company, or the application to the redemption, purchase or other retirement of any such stock of any moneys previously and properly set apart for and then held in a sinking or other analogous fund established for such stock.

For the purposes of this Section, the amount of any Stock Payment declared or paid or distributed in property of the Company shall be deemed to be the book value of such property (after deducting related reserves for depreciation, depletion and amortization) at the Computation Date, and the amount of any Stock Payment declared or paid or distributed in obligations of the Company shall be deemed to be the value of such obligations as of the date of the adoption of the Board Resolution authorizing such Stock Payment, as determined by such Board Resolution. The fair value of any obligations of the Company received by the Company as a contribution to capital or as the consideration for the issuance of stock of the Company (whether upon conversion of such obligations or otherwise) shall be the principal amount of such obligations.

Without regard to the foregoing restrictions of this Section, the Company may pay regular dividends upon shares of the Preferred Stock of the Company outstanding on, and may set apart money and apply the same to the purchase or redemption of shares of said Preferred Stock through the operation of the sinking fund provided for by the Company's Certificate of Incorporation as in effect on, but all amounts so paid, set apart and/or applied shall be included in all subsequent computations of Stock Payments for the purposes of this Section.

The Company will not permit any Subsidiary to purchase any stock of any class of the Company.

§ 10-13, Limitations on Dispositions of Assets—Transactions by Subsidiaries; Sample Covenant 1

III. Transactions by Subsidiaries of the Obligor

Indenture provisions which are made applicable to the consolidated activities of the Company and certain of its subsidiaries would usually include provisions which restrict the consolidation or merger of such subsidiaries and the disposition of their assets as an entirety or substantially as an entirety. Depending upon the significance of subsidiary operations, such transactions may have as important an effect upon the credit of the consolidated enterprise as transactions engaged in directly by the Company. Sample Covenant 5 illustrates one relatively simple way in which such activity by subsidiaries may be restricted.

In those cases in which the business conducted and assets held by subsidiaries of the Company are relatively important, it is not unusual to include substantive covenants restricting the merger of subsidiaries and the disposition of their assets by reference to funded debt and earnings tests applied after giving effect to the transaction in question. Thus, a subsidiary merger might be permitted only if the consolidated funded debt of the Company and its restricted subsidiaries continue to meet any conditions contained elsewhere in the indenture to the issuance of additional funded debt by the Company. Sample Covenant 6 illustrates this approach and combines a debt to capitalization and an earnings test for this purpose. The covenant is based upon the assumption that the indenture permits the issuance of preferred stock by subsidiaries to others than the Company under certain circumstances. If such is not the case, the earnings test should be limited to net earnings available for interest.

IV. Sample Covenants

SAMPLE COVENANT I

(Prohibiting any Disposition Which Considered with Prior Dispositions Would Have Adverse Effect)

§ 10-13. Restriction on Dispositions of Assets.

Subject to the provisions of Article Eight, the Company will not convey, transfer or lease, any substantial part of its assets unless, in the opinion

**§ 10-13, Limitations on Dispositions of Assets—
Sample Covenants 2 and 3**

of the Board of Directors, such conveyance, transfer or lease, considered together with all prior conveyances, transfers and leases of assets of the Company, would not materially and adversely affect the interest of the Holders of the Debentures or the ability of the Company to meet its obligations as they become due.

SAMPLE COVENANT 2

**(Prohibiting Dispositions of Substantial Parts of the Assets,
Except in the Ordinary Course of Business)**

§ 10-13. Restriction on Dispositions of Assets.

Subject to the provisions of Article Eight, the Company will not, otherwise than in the ordinary course of business, sell, lease, transfer or otherwise dispose of any substantial part of its properties and assets, including (but without limitation), any manufacturing plant or substantially all properties and assets constituting the business of a division, branch or other unit operation.

SAMPLE COVENANT 3

**(Providing for Prepayment of Funded Debt with, or Reinvestment of,
Proceeds of Dispositions of Fixed Assets in Excess of a Stated Amount)**

§ 10-13. Prepayment of Debentures in Connection With Dispositions of Fixed Assets.

If the Company in any calendar year and in one or more sales sells (other than in a sale and leaseback) any fixed assets acquired prior to [the date of a financial statement preceding the date of the Indenture] and receives therefor proceeds in cash or its equivalent amounting in the aggregate to \$1,000,000 or more after deducting taxes and expenses applicable to the sale, such cash or its equivalent shall, within 12 months after the close of such calendar year, be applied either (a) to the acquisition by the Company of other property or assets which are necessary or useful in its business, or (b) to the prepayment of an equal principal amount of Funded Debt of the Company, in which event such payment shall be prorated among all Funded Debt of the Company at the time outstanding, including the Debentures. If the Company is required to pay any of the Debentures pursuant to the provisions of the preceding clause (b), the Company may prepay such Debentures at the principal amount thereof plus

**§ 10-13, Limitations on Dispositions of Assets—
Sample Covenant 4**

accrued interest thereon to the date fixed for such prepayment, but (notwithstanding the provisions of § 11-1 hereof) without premium, provided that the interest on the Debentures so to be prepaid is provided from cash funds of the Company derived otherwise than from the proceeds of sale of such fixed assets.

If the Debentures are to be prepaid pursuant to the provisions of clause (b) of the preceding paragraph,

A. notice shall be given, in the manner provided in § 11-5, to the Holders of the Debentures so to be prepaid, which notice shall specify that such prepayment of Debentures is to be made pursuant to this § 10-13, and

B. the Company shall deliver to the Trustee an Officers' Certificate setting forth (1) a brief description, including all necessary computations, of the fixed assets sold by the Company, the proceeds in cash or its equivalent received therefor by the Company, the taxes and expenses applicable to such sale, and the amount of such proceeds which the Company proposes to apply to the payment of Funded Debt of the Company, (2) a statement as to the Funded Debt of the Company at the time outstanding, including the Debentures, and the amounts of such Funded Debt which the Company proposes to pay through the application of the proceeds of the sale of such fixed assets, and (3) a statement that the Debentures are being prepaid by cash funds of the Company derived from the proceeds of sale of such fixed assets.⁶

SAMPLE COVENANT 4

**(Providing for Restrictions on Issuance and Sale of
Subsidiary Stock and Indebtedness)**

§ 10-13. Restrictions on Issuance and Sale of Subsidiary Stock and Indebtedness.

The Company will not

(a) permit any Subsidiary to issue or sell any shares of stock of any class of such Subsidiary to any Person (other than the Company or a Wholly-owned Subsidiary), except for the purpose of qualifying directors or of satisfying pre-emptive rights or of paying a common stock dividend on, or splitting, common stock of such Subsidiary;

(b) sell, transfer or otherwise dispose of any shares of stock of any class (except to a Wholly-owned Subsidiary or to qualify direc-

⁶ It may be appropriate to refer to this type of prepayment in § 11-1 (Right of Redemption) by a cross-reference hereto.

**§ 10-13, Limitations on Dispositions of Assets—
Sample Covenant 4**

tors) or any Debt of any Subsidiary or permit any Subsidiary to sell, transfer or otherwise dispose of (except to the Company or a Wholly-owned Subsidiary or to qualify directors) any shares of stock of any class or any Debt of any other Subsidiary, unless:

(1) simultaneously with such sale, transfer or other disposition, all shares of stock and all Debt of such Subsidiary at the time owned by the Company and by every other Subsidiary are sold, transferred or otherwise disposed of;

(2) the Board of Directors has determined that the retention of such stock and Debt is no longer in the best interest of the Company and the Holders of the Debentures;

(3) such stock and Debt are sold, transferred or otherwise disposed of for a consideration and upon terms deemed by the Board of Directors to be adequate and satisfactory;

(4) if such Subsidiary owns, directly or indirectly, any shares of stock or any Debt of any other Subsidiary of which any other shares of stock or Debt are at the time also owned by the Company or another Subsidiary, simultaneously with such sale, transfer or other disposition all such other shares of stock and all such other Debt at the time owned by the Company and all other Subsidiaries are sold, transferred or otherwise disposed of and the Board of Directors has made the determination specified in the foregoing clauses (2) and (3) as to the sale, transfer or other disposition thereof;

(5) if the consideration for any such sale, transfer or other disposition includes shares of stock of any other corporation, immediately after such transaction such other corporation shall be a Wholly-owned Subsidiary; and

(6) if the consideration for any such sale, transfer or other disposition includes obligations of any other Person, the shares of stock and Debt so sold, transferred or otherwise disposed of are validly pledged as security for such obligations, free and clear of all other pledges and all mortgages, liens, charges and encumbrances, and under the terms of such pledge the pledgor covenants not to vote such shares for, or to permit any increase in the outstanding indebtedness for money borrowed or any increase in the outstanding number of shares of stock of any class of the corporation the shares or Debt of which are so pledged.⁷

⁷ A common alternative to clauses (5) and (6) is to require that the consideration be cash. This can be accomplished by deleting clause (6) and changing clause (5) to read as follows:

(5) the consideration received upon any such sale, transfer or other disposition is cash in an amount equal to the fair value of such stock and Debt.

**§ 10-13, Limitations on Dispositions of Assets—
Sample Covenant 5**

SAMPLE COVENANT 5

**(Providing Limitations on Merger, Consolidation or
Disposition of Assets by Subsidiaries)**

**§ 10-13. Limitation on Consolidation, Merger or Dispositions of Property
by Subsidiaries.**

The Company shall not permit any Subsidiary to

(a) consolidate with or merge into any other corporation unless the successor formed by or resulting from such consolidation or merger is the Company or a Wholly-owned Subsidiary;

(b) lease its properties as an entirety or substantially as an entirety, except to the Company or a Wholly-owned Subsidiary; or

(c) convey or transfer its properties as an entirety or substantially as an entirety, except to the Company or a Wholly-owned Subsidiary, unless

(1) the Board of Directors has determined that the retention of such properties is no longer in the best interest of the Company and the Holders of the Debentures;

(2) such properties are conveyed or transferred for a consideration and upon terms deemed by the Board to be adequate and satisfactory;

(3) if the consideration for any such conveyance or transfer includes shares of stock of any other corporation, immediately after such transaction such other corporation is a Wholly-owned Subsidiary;

(4) if the consideration for any such conveyance or transfer includes obligations of any other Person, such obligations are secured by a purchase money lien upon all or substantially all mortgageable fixed property so sold or otherwise disposed of (and all improvements and fixtures thereafter placed thereon) ranking prior to any other lien thereon other than liens to which such properties were subject when so sold or otherwise disposed of; and

(5) if such property includes any shares of stock of any class or any Debt of any other Subsidiary, the disposition thereof has been made in compliance with §⁸ hereof.

⁸ This reference is to a covenant restricting disposition of subsidiary stock. See Sample Covenant 4.

**§ 10-13, Limitations on Dispositions of Assets—
Sample Covenant 6**

Any conveyance or transfer pursuant to Subsection (c) of this Section shall be deemed to constitute a conveyance or transfer effected by the Company for purposes of §⁹ hereof.¹⁰

SAMPLE COVENANT 6

**(Providing Limitations on Merger, Consolidation or
Disposition of Assets by Subsidiaries)**

**§ 10-13. Limitations on Consolidation, Merger or Disposition of Property by
Subsidiaries.**

The Company shall not permit any Subsidiary to participate in any consolidation or merger with, or to convey or transfer its properties and assets as an entirety or substantially as an entirety to, another corporation, if

(a) immediately after such consolidation, merger, conveyance or transfer and after giving effect thereto, the principal amount of Consolidated Funded Debt of the Company and its Consolidated Subsidiaries plus the value of any Minority Interests in Subsidiaries would exceed the Consolidated Capitalization of the Company and its Consolidated Subsidiaries as shown by a pro forma Consolidated Balance Sheet as of a date not more than 90 days prior to the date such determination is made; or

(b) Consolidated Income of the Company and its Consolidated Subsidiaries Available for Interest and Dividends on Preferred Stock of Subsidiaries for the 12-month period ending on the date of said Consolidated Balance Sheet shall have been less than times the sum of (i) the total annual interest charges on the Consolidated Debt of the Company and its Consolidated Subsidiaries, and (ii) the total annual dividend requirements on Preferred Stock of Subsidiaries, in each case as outstanding immediately after such consolidation, merger, conveyance or transfer;

provided, however, that the restrictions contained in this Section shall not apply to or prevent the consolidation or merger of a Subsidiary with, or a conveyance or transfer of its properties and assets to, the Company or another then existing Subsidiary of the Company.

⁹ This reference is to a covenant similar to Sample Covenant 3 providing for prepayment of debentures in connection with disposition of capital assets. The sentence should be deleted if no covenant comparable to Sample Covenant 3 is contained in the indenture.

¹⁰ A common alternative to clauses (3) and (4) is to permit such sales of assets only for cash. This may be accomplished by deleting clause (4) and changing clause (3) to read as follows:

(3) the consideration received upon any such conveyance or transfer is cash in an amount equal to the fair value of such properties.

§10-16, Investments—Sample Covenants 1, 1A and 2

The Sample Covenants which follow illustrate the fact that an investment covenant can range from a simple but complete prohibition to a very complicated regulation of permissible investments in certain classes of subsidiaries.

V. SAMPLE COVENANTS

SAMPLE COVENANT 1

(Prohibiting All Investments)

§ 10-16. Limitation on Investments.

The Company will not, and will not permit any Subsidiary to, make any Investments in any Person.

SAMPLE COVENANT 1A

**(Prohibiting Investments with Exceptions for Government Obligations,
Commercial Paper and Certificates of Deposit)**

§ 10-16. Limitation on Investments.

The Company will not, and will not permit any Subsidiary to, purchase or otherwise acquire any capital stock, obligations or other securities of, make any capital contribution to, or otherwise invest in, any Person; provided, however, that nothing in this § 10-16 shall prevent the Company or any Subsidiary from purchasing (1) direct obligations of the United States of America, (2) prime commercial paper and (3) certificates of deposit issued by commercial banks.

SAMPLE COVENANT 2

(Permitting Investments in Subsidiaries)

§ 10-16. Limitation on Investments.

The Company will not, directly or indirectly, acquire, hold or own any share of the capital stock or any other equity security, or any option or right to acquire the same, of any corporation other than a Subsidiary of the Company or a corporation which immediately after such acquisition will be a Subsidiary.

§ 10-16, Investments—Sample Covenants 2A, 3 and 4

SAMPLE COVENANT 2A

(Limiting Investments to a Dollar Amount)

§ 10-16. Limitation on Investments.

The Company will not, and will not permit any Subsidiary to, make any investment in any Person (other than a Subsidiary or the Government of the United States of America or Canada or any agency or political subdivision thereof) whether (1) by acquisition of stock or indebtedness (other than indebtedness evidenced by commercial paper rated as prime and maturing within one year), or by loan, advance, guaranty, transfer of property, capital contribution or otherwise, or (2) by ownership or lease of any property of any kind located outside the United States of America or Canada (other than machinery, equipment, supplies, materials or goods acquired for shipment within 90 days to, and use, manufacture or sale within, the United States of America or Canada), if, after giving effect thereto the aggregate amount of all such investments of the Company and its Subsidiaries in such Persons and properties would exceed \$.....

SAMPLE COVENANT 3

(Prohibiting Loans, Advances and Investments with Exceptions)

§ 10-16. Limitations on Loans, Advances and Investments.

The Company will not, and will not permit any Subsidiary to, make any loans or advances to, or investments in, any Person; except

(1) loans and advances to, and investments in, the Company or any Subsidiary;

(2) loans and advances in the ordinary course of business not exceeding at any one time an aggregate of \$..... as to the Company and its Subsidiaries combined; and

(3) investments in direct obligations of the United States of America, prime commercial paper and certificates of deposit issued by commercial banks.

SAMPLE COVENANT 4

(Combined Restriction on Investments and Dividends)

§ 10-12 [or § 10-16]. Limitation on Dividends and Other Payments and Investments.

The Company will not declare any dividends (other than dividends payable solely in stock of the Company) on any class of its

§10-16, Investments—Sample Covenant 4

stock or make any payment on account of the purchase, redemption or other retirement of any shares of such stock or make any distribution in respect thereof, either directly or indirectly, or make any investment in any Person, unless, after giving effect to such proposed dividend, payment, distribution or investment, each of the following conditions is complied with at the date of such declaration, payment, distribution or investment (hereinafter called the "Computation Date"):

(1) the Net Tangible Assets of the Company are at least equal to . . % of the Funded Debt of the Company; and

(2) the sum of

(a) \$, plus (or minus in the case of a deficit),

(b) the Net Income of the Company computed for the period commencing, 19.. to and including the Computation Date, plus

(c) the aggregate amount of the net cash proceeds to the Company from sales subsequent to, 19.. of shares of any class of its stock, but only insofar as such proceeds do not exceed the aggregate amount of all cash payments made subsequent to, 19.., or then being made on account of the purchase, redemption or other retirement of any shares of any class of its stock

are greater than the sum of

(d) the aggregate amount of all such dividends declared and all such other payments and distributions made during such period commencing, 19.. to and including the Computation Date, plus

(e) the excess, if any, of (i) the amount of the aggregate unliquidated investment (computed as hereinbelow provided) on the Computation Date of the Company in all Persons, over (ii) \$, being the amount of the aggregate unliquidated investment (so computed) on, 19.. of the Company in all Persons.

For the purposes of this § 10-12 [or § 10-16], the amount of any dividend declared or other payment or distribution made in property of the Company, and the amount of any investment made through the transfer of property, shall be deemed to be the fair value (as deter-

§10-16, Investments—Sample Covenant 5

mined by the Board of Directors) of such property at the time of declaration, payment, distribution or investment.

For the purpose of any computation under this § 10-12 [or § 10-16] the aggregate unliquidated investment of the Company in any Person shall be computed in accordance with generally accepted accounting principles (subject to the next preceding paragraph) and shall include all investments by means of stock purchase, loan, advance, guarantee, capital contribution or otherwise, excluding

(A) amounts invested by the Company through the exchange of its stock for stock of a Person;

(B) undistributed earnings of a Person;

(C) write-ups, write-downs or write-offs after, 19.. of investments in any Person; and

(D) accounts receivable from any Person arising in the ordinary course of business from the sale of goods or services;

provided, however, that there shall not be deducted from the amounts invested in any Person any amounts received by the Company as earnings on its investment in such Person.

SAMPLE COVENANT 5

(Restriction on Investments Based on Net Worth Test
and Moneys Available for Dividends)

§ 10-16. Limitation on Investments.

The Company will not make any investment in any Person if, at the time of such investment and after giving effect thereto:

(1) the net amount of investments in all Persons for the period from, 19.. to the date of such proposed investment would exceed % of the Company's Capitalization; or

(2) the aggregate amount of the cash paid or to be paid and the fair value (as determined by the Board of Directors) at the time of delivery of any property delivered or to be delivered by the Company pursuant to all declarations and payments of dividends on, and distributions to the holders of, any shares of its capital stock of any class (except any dividend paid or distribution made solely in shares of its capital stock of any class) and all purchases, redemptions and

§10-16, Investments—Sample Covenant 6

other acquisitions for a consideration of any shares of capital stock of the Company of any class, made subsequent to, 19 . . . , plus the net amount of investments of the Company in all Persons for the period from, 19 . . . to the date of such proposed investment would exceed the sum of

(a) the Net Income of the Company for the period commencing on, 19 . . . and terminating at the end of the last calendar month preceding the date of such proposed investment, and

(b) the aggregate amount of the cash and the fair value at the time of its receipt by the Company (as determined by the Board of Directors) of all property received by the Company as consideration for any capital stock of the Company issued subsequent to, 19 . . .

For the purposes of this § 10-16, "investment"¹⁸ means all loans, advances, capital contributions and transfers of assets, and all purchases and other acquisitions for consideration by the Company of evidences of indebtedness, capital stock or other securities; and "net amount of investments"¹⁹ for any particular period means the gross amount of all investments made by the Company during such period less the aggregate amount of all cash received and the fair value (as determined by the Board of Directors), at the time of its receipt by the Company, of all property received by the Company during such period as payments of principal or premium, returns of capital, liquidating dividends or distributions, proceeds of sale or other dispositions, or otherwise in respect of such investments except to the extent that any such cash and fair value have been included in the income of the Company for such period.

SAMPLE COVENANT 6

(Limitation on Investments in Unrestricted Subsidiaries)

§ 10-16. Limitation on Investments in Unrestricted Subsidiaries.

The Company will not, and will not permit any Restricted Subsidiary to, make any Investment in an Unrestricted Subsidiary if, after giving effect thereto, Consolidated Net Tangible Assets would be less than \$

"Investment in Unrestricted Subsidiaries" means (a) all loans, cash advances, capital contributions and transfers of assets from the Company

¹⁸ Compare with the definition set forth in Sample Covenant 6 which contains an exception.

¹⁹ Compare with the Sample Definition of Net Amount in Part IV B of § 1-1(c) (Other Definitions).

§10-16, Investments—Sample Covenant 7

or Restricted Subsidiaries to Unrestricted Subsidiaries, except transfers for cash and/or other property (other than evidences of indebtedness, capital stock of other securities issued by any such Unrestricted Subsidiary) in an amount or having a fair value, in the opinion of the Board of Directors, equal to the fair value of the assets transferred, (b) all purchases and other acquisitions for a consideration by the Company or Restricted Subsidiaries of evidences of indebtedness, capital stock or other securities of such Unrestricted Subsidiaries and (c) all guarantees by the Company or Restricted Subsidiaries of indebtedness of such Unrestricted Subsidiaries; provided, however, that the issuance of stock of any class of the Company for the acquisition of an interest in an Unrestricted Subsidiary shall not be deemed an "Investment in an Unrestricted Subsidiary".²⁰

SAMPLE COVENANT 7

(Limitation on Investments and Loans to Unrestricted Subsidiaries)

§ 10-16. Limitation on Restricted Investments and Loans to Unrestricted Subsidiaries.

Neither the Company nor any Restricted Subsidiary will acquire for cash or other property (except stock of the Company) any Restricted Investment²¹ or any Debt of an Unrestricted Subsidiary for money borrowed or make any loan or advance to, or guarantee or become contingently liable in respect of or for the purchase or other acquisition of any Debt of any Unrestricted Subsidiary, unless, after giving effect to such action, the sum of

(1) the aggregate amount of cash (or other property, taken at a value determined by the Board of Directors) declared or paid as dividends (other than dividends in stock of the Company) on all shares of stock of the Company or distributed in respect of such shares of stock after, 19 . . . , and

(2) the aggregate amount of cash (or other property, taken at a value determined by the Board of Directors) applied to, or set apart for, the purchase (including purchases by Restricted Subsidiaries), redemption or retirement of shares of stock of the Company after, 19 . . . , and

²⁰ The use of the term Consolidated Net Tangible Assets in Sample Covenant 6 contemplates that the definition thereof would exclude from assets all Investments in Unrestricted Subsidiaries.

²¹ See Sample Definition of Restricted Investment in Part IV B of § 1-1(c) (Other Definitions).

Article Ten, Certain Other Covenants

(3) the Net Amount²² of Restricted Investments of the Company and its Restricted Subsidiaries acquired for cash or other property (except stock of the Company) after, 19.., or, in the case of any such Restricted Subsidiary which became a Subsidiary after, 19.., the date it became a Subsidiary, and

(4) the aggregate unpaid principal amount of Restricted Indebtedness²³ of all Unrestricted Subsidiaries at the time of such action,

will not be in excess of \$. plus (or minus in the case of a deficit) the Consolidated Net Income of the Company and its Restricted Subsidiaries accrued after, 19.. and plus the aggregate amount received as the net cash proceeds of sales of stock of the Company made after, 19...

All computations hereunder shall exclude any acquisition of shares of stock of the Company in exchange for other shares of stock of the Company, except to the extent that any cash or other property is paid or applied by the Company in connection with such exchange otherwise than in respect of accrued dividends on any Preferred Stock involved in such exchange.

For the purposes of the provisions of this § 10-16, if an acquisition of a Restricted Investment is made in a transaction involving the acquisition of property which is not a Restricted Investment and is made in part for stock of the Company and in part for consideration other than stock of the Company, such computations shall include the amount or fair value (as determined by the Board of Directors) of such consideration specifically allocated to the Restricted Investment, or, where no specific allocation is made, the same proportion of such consideration as the book value of the Restricted Investment is to the total book value of all the property acquired in the transaction at the time the transaction is effected.

**CERTAIN OTHER COVENANTS
(Negotiable)**

There are some boiler-plate type of indenture covenants that are not included in the Model Provisions. One of those covenants that has been quite common is a covenant not to extend the due date of or fund interest coupons or claims for interest. The draftsmen of the

²² See Sample Definition of Net Amount in Part IV B of § 1-1(c) (Other Definitions).

²³ See Sample Definition of Restricted Indebtedness in Part IV B of § 1-1(c) (Other Definitions).

